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C O N F I D E N T I A L SECTION 01 OF 02 TAIPEI 002887

SIPDIS

STATE PASS AIT/W

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SUBJECT: PRESIDENT ENDORSES INCREASE IN DEFENSE SPENDING

REF: TAIPEI 2745

Classified By: AIT Acting Director David J. Keegan, Reason: 1.4 (B/D)

11. (C) Summary: President Chen Shui-bian endorsed a proposal to move Taiwan's defense spending towards 3.0 percent of GDP during a closed-door June 29 National Security Council (NSC) meeting attended by the Premier and other senior Executive Yuan (EY) officials. NSC officials who proposed the increase told AIT that the President's endorsement should help Minister of National Defense (MND) Lee Jye in upcoming negotiations with the EY over the FY2006 budget. In addition to backing a medium term increase in defense outlays, officials at the June 29 NSC meeting also agreed in principle to allow MND to keep the proceeds from the sale of MND property around the island. In the past, proceeds went into the EY's general coffers, making MND reluctant to dispose of its considerable stock of under-utilized property. NSC officials express cautious optimism that defense spending can reach the 3.0 percent of GDP target in 2-3 years, but say that it will be difficult to secure Legislative Yuan (LY) approval for funding levels higher than that. End Summary.

Setting the Direction

12. (C) NSC Senior Advisor (responsible for political and media affairs) Lin Jin-chang told AIT that President Chen Shui-bian offered an unambiguous endorsement for increasing Taiwan's regular budget levels during a June 29 NSC meeting convened to discuss the defense policy portion of the proposed National Security Report (Reftel). Lin said that the NSC proposed increasing Taiwan's defense spending to 3.0 percent of GDP over the next several years. This target, he continued, would include funding from the annual defense budget and the proposed Special Defense Procurement Budget, but exclude money earmarked for veterans welfare. The June 29 meeting was attended by senior NSC officials and cabinet members in addition to President Chen, Vice President Annette Lu, and Premier Frank Hsieh.

13. (C) Lin noted that the President's June 29 remarks should give MND Minister Lee Jye a major leg up in upcoming budget negotiations with the EY. The EY traditionally makes significant cuts to budget requests submitted by individual ministries before forwarding the general budget to the LY in September. The EY generally seeks to make reductions uniform across ministries, unless there is a compelling political or policy reason to favor an individual account. Lin said that last year, MND was told by then-Premier Yu Shyi-kun that MND should be happy with its flat-line budget, since most other ministries were forced to reduce spending from FY2004 levels.

14. (C) Lin said the President's clear instruction, in the presence of the Premier, Finance Minister, and other EY leaders, should provide Hsieh the political cover he needs to buck tradition and support an increase for MND. "He can tell other ministries that he is simply following the President's orders and absolve himself of all blame," Lin said. The key now will be follow-up, Lin added. "Lee Jye is a straight guy, but not the best political operator around," Lin remarked, "we (the NSC) may need to stiffen his spine a bit before he goes head-to-head with the EY."

Creative Accounting

15. (C) NSC Senior Advisor (and former LY Defense Committee Co-chair) Chen Chung-hsin told AIT that the June 29 meeting also discussed increasing MND's funding from off-budget sources. Chen said that the most important decision at the meeting was agreement by the EY to waive rights to the proceeds of MND land sales. Chen noted that MND has been unwilling to sell off expensive properties it owns around the island (including two large lots in the high-priced vicinity of AIT) because the proceeds previously went into the government's general coffers. Selling or leasing this land could provide MND with an immediate inflow of cash for both procurement and operational accounts, he added.

Spending More, Spending Smarter

16. (C) Coming out of the June 29 meeting, Chen expressed confidence that the EY would request, and the LY would

approve, increases in defense spending to 3.0 percent of GDP through the regular and multi-year special budget processes by FY2008-9. Chen noted, however, that increases beyond 3.0 percent would be a much harder political sell. Given this reality, Chen asserted that Taiwan's military needs to focus more on managing its spending priorities. During the June 29 meeting, Chen said he argued for a review of pending procurement programs with an eye towards withdrawing requests to purchase certain systems, such as Apache attack helicopters and Paladin artillery systems. He added that Taiwan needed to husband resources in order to fund the replacement of aging fighter aircraft, upgrade C4ISR systems, and prepare for possible USG approval for the sale of Aegis destroyers.

Comment: Step Forward

17. (C) There seems to be a quiet consensus emerging in favor of increasing defense spending over the medium term, at least among those directly involved in the defense policy process. Ruling and opposition leaders on the LY Defense Committee have told AIT they are willing to endorse sustained increases in MND funding, as long as they can be convinced that the ministry has its priorities right. Of course, this apparently reasonable caveat has been the hook for much of the protracted opposition to the Special Defense Budget. The President's intervention is also a positive development. Last year, the NSC tried to back the MND in its budget battle with the EY, but the President appeared to remain on the sidelines. AIT will seek opportunities to assist those in the Taiwan government seeking a strategic increase in Taiwan's defense outlays, focusing our immediate efforts on persuading the EY leadership to accept proposed spending increases by MND. We will also register with the new KMT Chairman elected on July 16 that leadership on defense spending is the most effective way to establish credibility with Washington.

KEEGAN